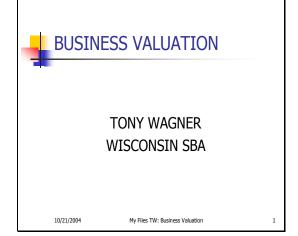
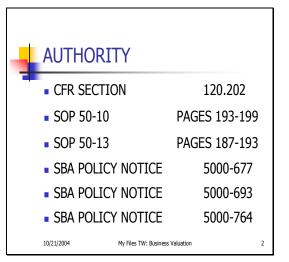
Handout for 'Sale of Business Financing and SBA' Training Class Via Ready Talk - October 20, 2004 Presented by Tony Wagner

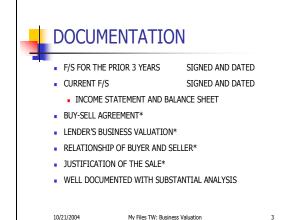
Slide 1



Slide 2



Slide 3





BUY-SELL AGREEMENT

- WRITTEN AGREEMENT
 - INTENT TO SELL
 - HOPEFULLY SIGNED
- SALE PRICE
- ASSETS TRANSFERRED
- LIABILITIES ASSUMED
- SELLER FINANCING
 - RATE, TERM. SECURITY
- CLOSING DATE
- ETC.

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LENDER'S VALUATION

- WRITTEN AND RETAINED
- MUST INCLUDE 2 METHODS
- SUPPORT/JUSTIFY (PROVIDE THE SOURCE)
 - CAP RATE
 - OFFICER'S COMP
 - ADJUSTMENTS TO EARNINGS
 - MULTIPLIER USED
- INCLUDE IN PACKAGE TO SBA IF REGULAR 7(A)
- SYNOPSIS ATTACHED IF SBAExpress

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CLOSE FAMILY MEMBERS

- SALE BETWEEN
 - SPOUSES
 - SIBLINGS
 - PARENT
 - CHILD
- PROFESSIONAL VALUATION REQUIRED
- TAX RETURNS IN FILE PRIOR TO APPROVAL*

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6



JUSTIFICATION OF THE SALE

- SALE MUST BE ARMS-LENGTH
- DISCUSS THE REASON FOR THE SALE
- SALE MUST BENEFIT THE BUSINESS
- BUYER'S PRIOR EXPERIENCE WITH THE BUSINESS
- DISCUSS THE BUSINESS TREND
 - FAILING BUSINESS
 - STABLE OR GROWING BUSINESS

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7

8

Slide 8



PRIOR SALE

- WITHIN 36 MONTHS
 - TWO APPRAISALS REQUIRED
 - OR
 - APPRAISAL AND REVIEW BY SECOND APPRAISER
 - OR
 - APPRAISAL AND SITE VISIT
 - **BY SENIOR BANK MANAGEMENT**
 - DOCUMENT DATE OF SITE VISIT
 - **DOCUMENT ITEMS REVIEWED**

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PARTIAL SALE

- NON-OWNER MUST BUY 100%
- NON-OWNER CAN NEVER BUY PART OF AN EXISTING OWNER'S INTEREST
- EXISTING OWNER CAN BUY OUT OTHER OWNERS
 - MUST RETAIN PROPORTIONAL OWNERSHIP
 - 1/3, 1/3, 1/3 BEFORE AND ½, 1/2 AFTER
- GUARANTEE OF ALL 20% OR MORE OWNERS IS REQUIRED

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ACCEPTABLE METHODS

- GROSS REVENUE MULTIPLIER
- ADJUSTED BOOK VALUE
- DISCOUNTED FUTURE EARNINGS
- CAPITALIZED ADJUSTED EARNINGS
- CASH FLOW
- OTHER GENERALLY ACCEPTED VALUATION METHODS

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10

11

Slide

11



GROSS REVENUE MULTIPLIER

- SALES ARE THE BASIS FOR VALUE
- SALES TIMES AN INDUSTRY MULTIPLIER ESTABLISHES VALUE
- GENERALLY PRIOR 12 MONTHS
- SHOULD BE A PUBLISHED AND RELIABLE SOURCE
 - SOURCE OF THE MULTIPLIER
- OF QUESTIONABLE VALUE

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12



ADJUSTED BOOK VALUE

- VALUE OF THE PHYSICAL ASSETS DETERMINES BUSINESS VALUE
- INCREASE THE BOOK VALUE OF THE ASSETS TO CURRENT APPRAISED INPLACE VALUE
- LESS ANY LIABILITIES ASSUMED
- ASSUMES NO GOODWILL VALUE OR BOOK OF BUSINESS VALUE (EXCEPT PURCHASED GOODWILL)
 - APPRAISALS FOR THE REAL ESTATE AND EQUIPMENT
 - REVIEW OF INVENTORY AND ACCOUNTS RECEIVABLE

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CASH FLOW METHOD

- CASH FLOW IS THE BASIS OF VALUE
- PROVIDE SUFFICIENT CASH FLOW TO
 - PAY ALL BUSINESS EXPENSES
 - SERVICE THE PROFORMA DEBT
 - ADEQUATELY REWARD MANAGEMENT
 - INCLUDING INCOME AND SELF EMPLOYMENT TAXES
 - REPLACE M & E WHEN NECESSARY

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13

14

Slide

14



DISCOUNTED FUTURE EARNINGS METHOD

- FUTURE EARNINGS IS BASIS FOR VALUE
- MUST BE BASED ON EXISTING OPERATIONS
- MUST USE REASONABLE
 - GROWTH RATE (historical)
 - GROSS PROFIT MARGIN (historical)
 - NET PROFIT MARGIN (historical)

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CAPITALIZED ADJUSTED EARNINGS METHOD

- PRIOR EARNINGS IS BASIS FOR VALUE
- ISSUES
 - CAP RATE
 - OFFICERS COMPENSATION
 - ADJUSTMENTS TO EARNINGS

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16



ADJUSTMENTS TO EARNINGS

- SELLER'S OFFICER COMPENSATION
- INTEREST
- DEPRECIATION/REPLACEMENT OF M & E
- RENT
- BUYER'S OFFICER COMPENSATION
- ABNORMAL MARKET CONDITIONS
 - PAST AND FUTURE
- OTHER

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16

17

Slide

17



OFFICER COMPENSATION

- SELLER'S OFFICER COMPENSATION
- SELLER SALARY/DRAW PLUS
 - CASH PLUS
 - PERSONAL AUTO
 - LIFE INSURANCE
 - OTHER

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Slide

18



OFFICER COMPENSATION

- WHAT IT WOULD COST TO HIRE A PROFESSIONAL TO MANAGE THE BUSINESS
- BUYER'S ABILITY TO LIVE ON A SMALLER SALARY OR REQUIREMENT FOR A LARGER SALARY DOES NOT AFFECT VALUE
- U. S. DEPT. OF LABOR WEB-SITE
- http://stats.bls.gov/
- http://www.salary.com/
- SOURCE OF THE OFFICER COMP. YOU USE

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http://stats.bls.gov/
http://www.salary.com/



MARKET COMPENSATION

- MANAGEMENT OCCUPATIONS TOP
 - Per Bureau of Labor Statistics website
 - Wages not total compensation

2002 2005 \$70,930 \$73,313

GENERAL MANAGERMARKETING MANAGERSALES MANAGER

\$80,290 \$87,516 \$76,340 \$83,106 \$67,860 \$73,967

CONSTRUCTION MANAGERFOOD SERVICE MANAGER

\$35,350 \$38,532

LODGING MANAGER

\$35,980 \$39,218

19

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Slide

20



BUSINESS CAP RATE

- SOP 50-13 ESTABLISHES A RANGE OF 15 – 30% FOR SMALL BUSINESSES
- JAMES H SCHILTZ "BUSINESS VALUATION REVIEW" ESTABLISHES A RANGE OF 16% TO 36%
- THE GREATER THE RISK THE LARGER THE CAP RATE
- SOP 50-13 DOESN'T ESTABLISH A RATE FOR BUSINESS REAL ESTATE

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20

Slide

21



REAL ESTATE CAP RATE

- SOP 50-13 DOES NOT ESTABLISH A CAP RATE FOR REAL ESTATE
- PER AL DASSOW OF CLIFTON GUNDERSON 8-12 %
 - 8%, NEWER, WELL LOCATED, LOW MAINTENANCE, MULTI USE, EASILY RENTABLE, EASILY SALEABLE, RESIDENTIAL, .
 - 12%, OLDER POORLY LOCATED, HIGH MAINTENANCE, SINGLE USE, NOT EASILY RENTABLE, NOT EASILY SALEBLE, COMMERCIAL

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PICKING THE CAP RATE

- SCHILTZ BASES RISK ON
 - PROFIT
 - COMPETITION
 - BARRIERS TO ENTRY
 - DEPT OF MANAGEMENT
 - TRADE POSITION

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22

23

Slide

23



COLLATERAL RISK

- RISK BASED ON LIQUIDATION VALUE OF THE COLLATERAL
 - GOODWILL NO RECOVERY HIGHEST RISK 30-36% CAP RATE
 - INVENTORY LIMITED RECOVERY MODERATE RISK 25% CAP RATE
 - M & E REASONABLE RECOVERY
 15 20% CAP RATE

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24



DEPRECIATION

- DEPRECIATION ON REAL ESTATE
 - GENERALLY AVAILABLE TO SERVICE DEBT
- DEPRECIATION ON M & E
 - GENERALLY NOT AVAILABLE TO SERVICE DEBT
- REPLACING M & E
 - REPLACEMENT MAY EXCEEDS DEPRECIATION

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OTHER ISSUES

- SELLER'S FINANCING
 - STANDBY OR SUBORDINATE
 - EXTEND TERMS *
- NON-COMPETE
 - LIMITED TERM AND DISTANCE ARE GENERALLY **ENFORCABLE**
- TRANSITIONAL MANAGEMENT
 - ADDS TO VALUE
 - ADDS TO LENDER/SBA COMFORT

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25

26

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26



PROPERTY BEING SOLD

- MOST OF THE METHODS ASSUME AN ASSET ONLY SALE
 - ALL BUSINESS ASSETS

EXCEPT

- CASH
- ACCOUNTS
- REAL ESTATE
- DEBT FREE SALE
 - NO ACCOUNTS PAYABLE ASSUMED
- NO ADDITIONAL W/C NEEDS

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27



PROPERTY BEING SOLD

- ADJUST FOR
 - DEBT OR LIABILITIES BEING ASSUMED
 - REAL ESTATE ?
 - ADDITIONAL FINANCING NEEDS
 - EQUIPMENT PURCHASES IF NOT IN DEPRECIATION/ M&E REPLACEMENT

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Slide

29



GAS IT UP C-STORE

- ADJUSTMENTS TO PURCHASE PRICE
 - CASH?
 - ACCOUNTS?
 - REAL ESTATE?
 - DEBT/LIABILITIES ASSUMED?
 - ADDITIONAL FINANCING NEEDS?
 - ADDITIONAL M&E NEEDS

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30



GAS IT UP C-STORE

- ADJUSTMENTS TO THE INCOME STATEMENT
 - SELLER'S SALARY/BUYER'S SALARY
 - INTEREST
 - DEPRECIATION
 - RENT
 - NON-RECURRING ITEMS
 - ABNORMAL MARKET CONDITIONS
 - REPLACEMENT OF M&E

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30



GAS IT UP C-STORE

- GROSS REVENUE MULTIPLIER
- TOM WEST "BUSINESS REFERENCE GUIDE"
- .25 x annual sales plus real estate and M & E

X \$1,625,097 = \$406,274

■ Plus Real estate and M & E \$450,000 \$956,274

Total value

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32

Slide

32



GAS IT UP C-STORE

ADJUSTED BOOK VALUE

Real Estate \$200,000

\$250,000 ■ M & E

Inventory \$40,000

> Total \$490,000

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Slide

33



CAPITALIZED ADJUSTED EARNINGS

BUSINESS CAP RATE PER SCHILTZ

 CATAGORY 3 21-25%

10% COMMERICAL REAL ESTATE

WEIGHTED CAP RATE

BUSINESS 21% x 440,000/640,000 = 14,438

• REAL ESTATE 10% x 200,000/640,000 = <u>3.125%</u> TOTAL 17.563%

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CAPITALIZED ADJUSTED EARNINGS

	<u>2001 </u>	<u>2002</u>	<u>2003</u>
Net Profit	48,551	53,821	40,020
Seller's Comp	19,950	19,800	12,600
Seller's Interest	19,576	16,440	14,222
Seller's Dep.	7,876	4,994	4,904
Reasonable Comp.	(40,000)	(40,000)	(40,000)
Repl. M & E	(5,000)	(<u>5,000</u>)	(<u>5,000</u>)
TOTAL	50,953	50,055	26,746
Weighting	<u>x 1/6</u>	<u>x 1/3</u>	<u>x 1/2</u>
Weighted Adj. Earn	8,492	16,685	13,373

34

Total weight \$38,550 / 17.6% = \$219,034

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Slide

35



CASH FLOW/SANITY CHECK

		2002	2003	
NET PROFIT		53,821	40,020	
SELLER'S COMP.		19,800	12,600	
SELLER'S INTEREST		16,440	14,220	
SELLER'S DEPRECIAT	ION	4,994	4,904	
REASONABLE OWNER	'S COMP	(40,000)	(40,000)	
REPLACE OF M & E		(5,000)	(5,000)	
TAXES		(6,000)	(4,000)	
CASH FLOW AVAILAB	LE FOR D/S	44,055	22,744	
PROFORMA D/S		48,341	48,341	
EXCESS SHORTFALL		(4,286)	(25,597)	
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Slide

36



CASH FLOW 2

- Value using 2003 cash flow
 - \$22,744/yr will service20 years @ 7%
- \$244,559 of debt
- PlusValue
- <u>\$100,000</u> of equity \$344,559
- Value using 2002 cash flow
 - \$44,055/yr will service
- \$473,710 of debt
- 20 years @ 7%
-
- PlusValue
- \$100,000 of equity \$573,710

36

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